

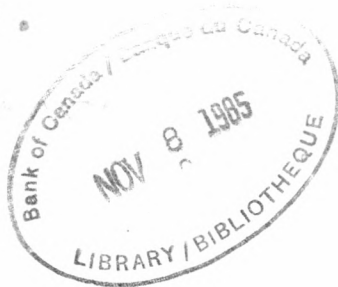
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BANK OF CANADA.

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Notes for an opening statement by
Gerald K. Bouey
Governor of the Bank of Canada
before the
House of Commons Legislative Committee
Considering Bill C-79
November 4th, 1985

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Mr. Chairman, I really do not have much to say about the involvement of the Bank of Canada with the Canadian Commercial Bank and the Northland Bank that you may not already have heard. However, in case you might find it helpful, I have distributed to you copies of the statement I made on May 9th before the Standing Committee on Finance, Trade and Economic Affairs and part of a speech I gave in September that deals with this matter. I propose this evening to summarize those remarks for you very briefly and to elaborate on them in a couple of places.

The Bank of Canada's involvement with these two banks has arisen from the powers Parliament has given to it in the Bank of Canada Act. These powers permit the Bank to act as lender of last resort for Canadian chartered banks in the case of liquidity difficulties, a standard responsibility for central banks. If a chartered bank is encountering withdrawals of funds it cannot readily meet out of its own resources, the Bank of Canada can advance funds in order to prevent a loss of confidence from spreading and to give a sound institution time to demonstrate that a loss of confidence by its depositors is unjustified. By law, any such loans must be made on a secured basis. Moreover, since the object is just to provide temporary liquidity

support, the policy of the Bank has been to lend only to institutions that are judged to be solvent.

The Bank is not able to make such assessments itself. Parliament has not given us the responsibility or the powers that would enable us to monitor the financial soundness of chartered banks or supervise their behaviour. In some countries the central bank does have responsibility for supervision. In this country the system of bank supervision, based on an information network of external bank auditors, internal bank inspection and bank management, was designed by Parliament to operate separately from the Bank of Canada. The contact of the Bank of Canada with this system is of course with the Inspector General of Banks, and we rely on him for judgements about the solvency of banks that come to us for liquidity help.

The Bank of Canada was thoroughly involved in the discussions last March that led to the establishment of a support package for the Canadian Commercial Bank, but we were not in a position to provide information to that part of the discussions bearing on the condition of the bank and therefore how large the support package needed to be. The judgement about the size of the support package required to make the bank solvent and viable was based on the information available at the time the decision had to be made, a judgement that I regarded as reasonable in the circumstances. The Bank of Canada therefore wholeheartedly supported the effort to save the bank. Since the bank was judged to be solvent and viable, the Bank of Canada was prepared to provide whatever liquidity support was required. We continued to make advances right up to the time -- September 1st -- that we received

notification from the Inspector General of Banks that in his opinion the Canadian Commercial Bank could no longer be considered viable.

In the period from March through to September, as our advances to the CCB were rising, the Bank of Canada carefully monitored the situation through frequent contacts both with the Inspector General of Banks and his staff and directly with the management of the CCB. Officers of the Bank of Canada were in Edmonton frequently through this period. Initially their role was to ensure that the legal agreement needed to take security for our advances was properly documented and registered and that it did indeed provide the necessary collateral. Arrangements were also set up to keep the Bank of Canada up-to-date on the CCB's current funding needs, on the maturity structure of its deposits and on the bank's plans and efforts to deal with its problems.

The Bank of Canada was kept fully informed of the results of efforts by the Inspector General to supplement the information on the state of the bank obtained from the CCB's management and its external auditors with assessments of various parts of the loan portfolio by practicing bankers temporarily seconded from other banks. We were encouraged by the fact that the Inspector General of Banks took action in the early summer to employ some retired bankers to have a more extensive look at the CCB's whole loan portfolio. By June our advances to the CCB had almost reached \$1 billion, and it had become quite evident that confidence among depositors in the bank was not likely to return very soon.

Although a great many depositors left the CCB, in the end it did not fail because of lack of funding. While it was still judged viable, the Bank of Canada provided all the liquidity that the bank required. It failed because of problems with its loan portfolio.

After the support package was arranged for the CCB the Northland Bank also came under pressure and the Bank of Canada made substantial, secured advances to it on the understanding that it was solvent and viable, and we continued to do so until we received a similar notification of non-viability on September 1st.

That is all I have to say by way of introduction, Mr. Chairman, except to emphasize that the Bank of Canada did all it could to save the two banks. I shall be glad to answer your questions.

Copies of Public Statements by
Gerald K. Bouey
Governor of the Bank of Canada
regarding the
Canadian Commercial Bank
and Northland Bank
provided to the
House of Commons Legislative Committee
Considering Bill C-79
November 4th, 1985

Statement regarding the Canadian Commercial Bank
prepared for an appearance
by Gerald K. Bouey
Governor of the Bank of Canada
before the
House of Commons Standing Committee
on Finance, Trade & Economic Affairs
Thursday, May 9th, 1985

The Bank of Canada's current degree of involvement with the Canadian Commercial Bank arises from the powers Parliament has given it in the Bank of Canada Act. These powers permit it to act as lender of last resort for Canadian banks in the case of liquidity difficulties, a standard responsibility of central banks.

The Bank of Canada first learned of the particular difficulties confronting the Canadian Commercial Bank when Mr. McLaughlan called on me on March 14th. From that point on I and senior officers of the Bank were in close contact on this matter with the Office of the Inspector General of Banks and other relevant parties in Ottawa. In the ensuing discussions I made known my view that, having regard to the adverse impact of a bank failure at this particular time on the Canadian financial system and the Western Canadian economy, an effort should be made to provide support to the Canadian Commercial Bank if a satisfactory arrangement could be arrived at with other participants. On Wednesday, March 20th, on behalf of the Ottawa group, I invited the six largest chartered banks to send representatives to a meeting on March 22nd at the Bank of Canada in Ottawa to discuss with the Inspector General of Banks, the Deputy Minister of Finance, the Acting Chairman of the Canada Deposit

Insurance Corporation and myself the situation of the Canadian Commercial Bank and what might be done to improve it. At an early stage in this meeting I, as the Chairman, made an explicit point of asking each bank representative whether an effort should be made to provide support for the Canadian Commercial Bank. No bank representative said that the effort should not be made. The meeting of March 22nd gave rise to further meetings over the weekend that resulted in the announcement of the \$255 million support package on Monday, March 25th.

As a result of this agreement to inject substantial additional capital funds into the Canadian Commercial Bank, I was able to provide public assurances on March 25th, at the time the support package was announced, that the Bank of Canada stood ready to lend to the Canadian Commercial Bank for its liquidity needs. Subsequently, and as was anticipated by the statement of March 25th, and reiterated in the Bank of Canada press release of April 18th, the Bank of Canada has made substantial secured advances at the Bank Rate to the Canadian Commercial Bank for liquidity purposes and it will if necessary continue to do so.

Extract from a Luncheon Address
given by Gerald K. Bouey
Governor of the Bank of Canada
to The Canadian Club
Toronto, September 23, 1985

Perhaps I should start by stating what our role in regard to banks experiencing difficulties is not. The Bank of Canada is not involved in monitoring the financial soundness of individual banks and supervising their behaviour. Parliament has not given us that responsibility or the powers that would enable us to fulfil that function. The Bank of Canada has no bank auditors, no bank examiners, no power to require details of individual loans, deposits or any other kind of private transaction. This situation seemed to come as a surprise to some people. The misunderstanding probably stemmed from the fact that supervisory arrangements are quite different in some other countries. In many, including Britain, the central bank is solely responsible for the supervision of banks. In the United States the responsibility at the federal level is shared among the Federal Reserve System, the Comptroller of the Currency and the Federal Deposit Insurance Corporation. In this country the system of bank supervision, based on an information network of external bank auditors, internal bank inspection systems and bank managements, was designed by Parliament to operate separately from the Bank of Canada, and the Bank must rely on the judgements that emerge from it.

Thus, although the Bank of Canada was thoroughly involved in the discussions last March that led to the establishment of a support package for

the Canadian Commercial Bank, it was not in a position to provide information to that part of the discussions bearing on the condition of the bank and therefore on how large the support package needed to be. The judgement about the size of the support package required to make the bank solvent and viable was based on the best information available at the time the decision had to be made. And I regarded that judgement as reasonable in the circumstances. The Bank of Canada therefore wholeheartedly supported the effort to save the bank. That is why I stated publicly at the time, and repeated subsequently, that since the bank was judged to be solvent and viable the Bank of Canada would provide whatever liquidity support was required.

And after the support arrangements had been agreed upon, the Bank of Canada performed in accordance with its responsibility to supply liquidity to chartered banks. It continued to make advances right up until the time -- September 1st -- when it received notification from the Inspector General of Banks that in his opinion the Canadian Commercial Bank could no longer be considered a viable operation. By then our advances outstanding, secured by assets of that bank, amounted to \$1,316 million.

Although a great many depositors left the Canadian Commercial Bank, in the end it did not fail because of lack of funding. While the Canadian Commercial Bank was still judged viable, the Bank of Canada provided all the liquidity that the bank required. It failed because of problems with its loan portfolio.

That the effort to save the Canadian Commercial Bank was not successful does not mean that none should have been attempted. I believe the blow to confidence in our financial system both in Canada and abroad would have been very severe indeed if the first bank failure in over sixty years had been allowed to occur suddenly without a serious attempt to prevent it.

The Bank of Canada also made substantial, fully secured advances to the Northland Bank on the understanding that it was solvent and viable, and we continued to do so until we received a similar notification of non-viability. At the end of August the outstanding advances amounted to \$510 million.

The Bank of Canada can expect to recover all the funds it has advanced to these two banks on a secured basis but of course it is a matter of very great regret that their problems have not been solved through this liquidity support.

I think this account underlines quite clearly the role the Bank of Canada plays in helping to preserve the stability of our financial system. That role is one of providing liquidity support to solvent banks that are encountering withdrawals of funds they cannot readily meet out of their own resources. It would be foolish to force a bank to call its loans and sell off its assets at fire-sale prices because of a temporary withdrawal of funds. The duty of the Bank of Canada is to advance funds to banks needing help on these occasions in order to prevent a loss of confidence from spreading and to

give a sound institution time to demonstrate that a loss of confidence by its depositors was unjustified.

Let me emphasize this last point. The fact that our massive liquidity support for the Canadian Commercial Bank did not in the end prove to be a sufficient remedy does not in any way call into question the need for the Bank of Canada to provide such support should any other bank ever require it. The Bank stands ready to carry out that responsibility.

In concluding, let me remind you that these problems occurred in institutions that constitute only one per cent of the assets of the Canadian banking system. A good banking system is absolutely essential for a well-functioning economy. We Canadians have for many years been justifiably proud of our banking system, and the Bank of Canada will play its part in ensuring that the system remains strong in the future.